Volume 4 - Issue 9 **September 2012**

The Franchise Valuations Reporter

See You in L.A.

I look forward to seeing many of our readers at the annual meeting of the American Bar Association **Forum on Franchising** to be held in Los Angeles October 3-5.

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
212.689.0400

Our Expertise

Within the franchise, distribution and dealership context, we are experts in:

- Damages, Valuations & Expert Testimony
- Finance, Accounting and Tax
- Cyber Security and E-discovery of Electronically Stored Information

We offer a free initial consultation. If any readers have questions, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
212.689.0400

Baby Boomers in Franchising Must Have Exit Strategies

Proper Planning Using Franchise Valuations' Expertise

There are about 40 million baby boomers in the US and more than 5 million similarly situated in Canada.[1] Between 2010 and 2020 that population segment in the US is projected to grow to 55 million, a 36% increase. In the case of franchise owners approaching retirement age, whether franchisees or franchisors, the most valuable asset they own - indeed often far more than 50% of their net worth - is tied up in their franchise companies. What should they do?

At a minimum, they must consider the topics below that apply to them and devise and implement appropriate plans and solutions - complete with the required documents and procedures.

1. ***Succession Plan*** - This is a business contingency plan. The question to be asked is what happens if the principal walks out of his or her business and is killed by a bus or a stray bullet? What, if any, are the restrictions in the franchise agreement that apply to transferees? How will a headless franchisor continue?
2. ***Estate Plan*** - This is a dispositive scheme that first, must consider a possible sale and, after that, is generally accomplished by wills, trusts, LLC Agreements, Shareholders' Agreements, Family Partnership Agreements, life insurance trusts and/or other revocable and irrevocable trusts.
3. ***Estate Tax Plan*** - This is a consideration only where the estate is worth more than $5 million under the current estate tax scheme. But who knows what the situation will be after the election? And there are many franchise owners that have assets worth far more than the threshold for estate taxation. With estate tax rates exceeding 40%, advance planning is essential. People with these types of success problems must consider valuation discounts for lack of marketability and minority interests and must consider how any such estate tax liability will be met so as to avoid a forced liquidation.
4. ***Valuation*** - If a franchise owner is going to sell, or die and dispose of his or her franchise by bequest, the value of the business must be determined. It is essential in any estate tax determination to know the value of the franchise on which the tax is potentially to be levied, but valuation is a key factor in all exit strategy planning.

Getting Started on a Succession Plan

A succession plan is a set of directions that is not properly part of a franchise owner's estate plan and therefore the strategy would not be included in documents such as his or her will or revocable trust. The most important considerations in formulating the Succession Plan are:

1. Who will run the franchise business if the principal is incapacitated or dies?
2. Should the business be sold, continued, or liquidated?
3. If there are questions about 1 and 2 above, who should be

Franchise Technology Risk Management

Our franchise law and computer forensics experts provide consulting and implementation of all aspects of cyber security, ESI management and e-discovery for franchise systems - from preparation of cyber security and ESI-related policies and procedures manuals through collection, preservation, processing, production and presentation.

To inquire about our services, please e-mail
Henry@FTRM.biz
or call (212) 689-0400

DISCLAIMER

The information provided in this newsletter is for informational purposes only and should not be construed as legal or expert advice which can only be obtained from appropriate professionals. Franchise Valuations, Ltd. and Franchise Technology Risk Management provide such expert advice on the topics addressed herein.

Please visit our websites at
www.FranchiseValuations.com
and
www.ftrm.biz

consulted? What adviser will have all the facts, and hopefully answers?

And because most franchise owners are novice sellers, never having disposed of a business before, they may make mistakes. According to Meg Schmitz, a senior franchise consultant with FranChoice in Chicago[2]:

- They often lack preparation. Sellers should have a plan/strategy to sell well in advance of making the sale. For most this should be at least three years out.
- They often will fail to have an accurate valuation done on their business by a qualified third party expert. This in turn, gives sellers an inflated view of the value of their business.
- They fail to organize the books and records.
- Customer/vendor/employee issues are not dealt with properly prior to sale.
- They lose their motivation, passion, commitment and momentum when they consider sale or retirement. The truth is if they want to sell the business, they should try to increase revenues, because increasing sales are important to buyers as they analyze possible targets.
- They fail to de-emphasize the owners' personal role in the business.

At Franchise Valuations Ltd. we have over 30 years' experience working with business owners on these issues. Look for more details on estate planning, estate tax planning and valuations for Boomer franchisees in future issues of The Franchise Valuation Reporter.

---

[1] U.S. Department of Health and Human Services, Administration on Aging, "A Profile of Older Americans: 2011" and Statistics Canada, "2011 Census: Age and Sex," News Release May 29, 2012.
[2] Quoted by David Wolinsky in "Mistakes to Avoid When Selling Your Chain."

Damages

Post-Judgment Interest in Federal Diversity Lawsuits

In the recent case of *Cappiello v. ICD Publications*,[1] the dispute was over the applicable post-judgment interest rate to be used in computing damages. Both sides agreed that the pre-judgment interest applicable was the New York rate under the *Erie v. Tompkins* rule, because pre-judgment interest is deemed part of the substantive cause of action.

But in *Cappiello* it was held that the federal rate, which is computed pursuant to a formula that adopts Treasury yields and came to only 0.25%, applied, as opposed to the New York State rate of 9%. The court ruled that post-judgment interest is a procedural matter, where federal law continues to govern.

---

[1]2012 WL 2051146 (EDNY, June 7, 2012)

Attorneys' Fees

Prevailing Party Defendants Recover

Claims for attorneys' fees by prevailing parties in copyright disputes in the Seventh Circuit are faced with a two-part test that measures 1) the strength of the prevailing party's case and 2) the amount of the relief obtained by the prevailing party.[1] When the claim is frivolous and the prevailing party is a

defendant who has not otherwise obtained damages (through a counterclaim, for example), the presumption to award attorneys' fees is "compelling."

In a suit brought by the estate of a deceased songwriter, music publishers who prevailed as defendants upon dismissal with prejudice of copyright and related claims, were awarded attorneys' fees by the federal district court in Chicago[2] even though a motion for sanctions was denied because, although the plaintiff's claims were objectively unreasonable, they did not vexatiously multiply the proceedings under 28 U.S.C. §1927.

. . .While Other Prevailing Lanham Act Counter-Defendants Do Not Recover

In another recent federal lawsuit the court held that the Plaintiff was not entitled to attorneys' fees in spite of successfully defending a trade dress and fraud counterclaim.[3] Courts may award attorneys' fees to the prevailing party in Lanham Act cases if the case is found to be exceptional but this generally involves trademark infringement that was willful, fraudulent, or malicious. Additionally, prevailing defendants may be awarded attorneys' fees if the plaintiff's action was groundless, unreasonable, vexatious, or pursued in bad faith.

In the instant case, a magistrate judge found that the defendant's counteraction qualified as exceptional because it failed to present evidence of the basic elements of its infringement and fraud claims. Nonetheless, the court found that plaintiff Gallo was not entitled to attorneys' fees. Although a court may award attorneys' fees on the basis of groundlessness alone, courts generally consider multiple aspects of the litigation together to determine whether the case is exceptional enough to warrant attorneys' fees pursuant to the Lanham Act. The court held that defendant Proximo's failure to address an essential element of its trade dress counterclaims was insufficient, by itself, to merit an award of attorneys' fees. The court further held that there was a reasonable or legal basis to believe in success on the merits of Proximo's infringement claims at the time this action was initiated or during discovery. Proximo did not pursue the action vexatiously or unreasonably. Thus, no award of attorneys' fees.

---

[1]*Assessment Techs. of WI, LLC v. WIREData, Inc.*, 361 F.3d 434, 436-437 (7th Cir. 2004).
[2]*Estate of Joe Brown v. Arc Music Group*, (August 17, 2012, Leinenweber, H.), Case No. 10 C 7141
[3]*E&J Gallo v. Proximo Spirits, Inc.*, August 23, 2012; Case No. CV-F-10-411 LJO JLT

Tax Nexus

California ~ Sales and Use Tax: Click-Through and Affiliate Nexus Provisions Operative September 15

According to California Director of Finance Ana Matosantos, and pursuant to California law, as no superseding federal law on the issue has been enacted, the California Click-Through and Affiliate Nexus Provisions become operative September 15.

Letter, Department of Finance, Office of the Director, August 15, 2012

California ~ Corporate Income Tax: Mandatory Single Sales Factor Apportionment Formula Bill Fails to Pass

According to CCH, the California Legislature has adjourned without passing a bill that would have required most multistate taxpayers to utilize a single sales factor formula to apportion their business income for purposes of

determining their corporation franchise and income tax liability, effective beginning with the 2012 tax year. The bill, A.B. 1500, had been approved by the Assembly on August 13, 2012, but was rejected by the Senate on the last day of the legislative session.

This is a benefit to franchise companies that have no property or equipment in California as it allows them to continue to use the allocation formula and be subject to tax at a much lower effective rate.